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ADOPTION OF THE REPORT OF THE COMMISSION ON ITS SEVENTEENTH SESSION

Draft report

Addendum

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Chapter ____

RECENT DEVELOPMENTS RELATED TO TRANSNATIONAL CORPORATIONS AND INTERNATIONAL ECONOMIC RELATIONS

1. The Commission considered item 3 of its agenda at its 1st to 4th meetings, on 10 and 11 April 1991. It had before it the report of the Secretary-General on the triad in foreign direct investment (E/C.10/1991/2).

2. In his opening statement, the Executive Director of the United Nations Centre on Transnational Corporations said that foreign direct investment had emerged as one of the key variables shaping international economic relations and world development. Global flows of foreign direct investment had increased far more rapidly than had world trade and output: between 1983 and 1989 the value of foreign direct investment flows had grown by 30 per cent a year versus only 9 per cent a year growth of world exports and 8 per cent growth of world output in current values. He pointed to widespread attempts by countries to attract foreign direct investment, but noted with concern the declining share of developing countries. Although flows of foreign direct investment to developing countries had increased in absolute terms by 78 per cent between the period 1980-1984 and 1985-1989, their share in total inflows had fallen from 25 per cent to 19 per cent. Moreover, the distribution

of those inflows remained highly concentrated, three quarters of the foreign direct investment flows to developing countries having gone to only 10 countries, of which only one was an African country.

3. Two interlinked forces were highlighted as having a profound impact on the global distribution of foreign direct investment inflows: the regionalization of markets and the increasingly tripolar structure of the international economic system, with Japan, the United States of America and the European Community forming the three poles of what was widely referred to as the "triad". The triad currently accounted for over four fifths of total outward foreign direct investment stock. About half of that had been invested in the triad itself. Although the triad had remained the focus of world-wide foreign-direct-investment activity, both inward and outward, the Executive Director noted that most developing countries were strongly linked to one or more triad members through foreign direct investment. Such linkages were due to either traditional historical and cultural links or the regional strategies of transnational corporations from the triad. In that regard, the Executive Director expressed concern that the majority of developing countries might be left out of the strategies of transnational corporations from the triad. That possibility was even more disturbing because foreign direct investment, trade, technology and financial flows were interlinked to a significant extent through transnational corporations. Therefore, marginalization in respect of foreign direct investment might also imply marginalization in terms of trade and technology transfer. The Executive Director called for coordinated policy measures by host and home countries and international institutions to correct the imbalance between developed and developing countries.

4. Most delegations shared the view that foreign direct investment had been emerging as an engine of growth. They pointed to the fact that foreign direct investment had grown much faster than trade and world output in the 1980s and that the role of transnational corporations as providers of capital, technology, access to export markets, and technical and managerial skills was a key factor in the economic development and competitiveness of countries. It was observed that foreign direct investment could play an important role in the restructuring of newly opened economies. It was noted that policy changes that created a more congenial environment for foreign direct investment by a wide spectrum of countries attested to the recognition of the potential role of transnational corporations as a significant determinant of development.

5. Many delegations addressed themselves to the finding of the report that world-wide foreign direct investment was dominated by the triad. That was due to a number of factors, including the strategic choices of transnational corporations propelled by the considerations of market size, technology and a stable economic and policy environment. Other factors included increased regionalization among developed countries, particularly in North America and Europe. Some delegations agreed with the conclusion of the report that the European Community might be properly considered a single home country for foreign direct investment, although one delegation called for further evidence in that regard. Many delegations were concerned with the finding that an increasing share of foreign direct investment was being located in the triad

and that there was the possibility of the further relative decline of developing countries. One delegation noted that while many developing countries were far from the triad, the actions of the triad had a direct impact on them, and expressed concern about the resultant gap in competitiveness between developed and developing countries. It was mentioned that the regional clustering of countries around the triad members must not become exclusionary groupings with the potential danger of division of markets among triad members and the exclusion of a large number of developing countries. However, some delegations felt that that issue warranted further research.

6. Many delegations noted with concern that despite the creation of a more congenial policy environment for foreign direct investment by many developing countries, their share remained low and showed a declining trend during the 1980s. They expressed concern about the concentration of foreign direct investment in the triad and in a small number of newly industrialized and resource-rich developing countries. Some delegations noted that the report had not adequately addressed the declining position of Latin America in the global distribution of foreign direct investment flows.

7. In the context of the declining share of foreign direct investment flows to developing countries, it was observed that many of those countries had opened their economies to foreign direct investment with the liberalization of investment codes, which included opening up more sectors, removal of restrictions on foreign ownership, guaranteed profit repatriation and provision of greater fiscal incentives as well as liberalization of foreign exchange and trade regimes, but those measures had not resulted in significant inflows of foreign direct investment. One delegation agreed that liberalization, while an important first step, was not in itself adequate to increase foreign direct investment in developing countries, and another pointed out the danger of "beggar thy neighbour" policies in offering greater incentives. Furthermore, it was noted that developing countries' problems were compounded by the competition resulting from the opening up of Eastern and Central Europe to foreign direct investment.

8. Many delegations noted that traditional means of attracting transnational corporations were no longer sufficient, and that emphasis needed to be placed on increasing domestic demand and improving human resources and infrastructure. Several delegations recognized the efforts of developing countries to integrate into regional groupings as an important strategy to attract foreign direct investment. Several delegations discussed their own Governments' efforts in the formation of regional markets.

9. Many delegations stressed the need for policies and incentive measures to be taken by home countries to encourage investment in developing countries. One delegation noted that such measures had already been taken with regard to investment in Eastern and Central Europe. Specific recommendations included measures to disseminate market information, assistance for technical and feasibility studies, financial and fiscal incentives by home countries, and trade liberalization.

10. In addition to home country policies, many delegations stressed the need for developed countries to facilitate changes in the external economic environment affecting foreign direct investment inflows to developing countries. Specifically, that called for a reduction in protectionism, debt forgiveness, increased official development assistance and removal of restrictions on outflows of capital and technology. Some delegations called for special attention to be paid to the least developed countries. A number of delegations mentioned the importance of improvement in the investment climate in developing countries.

11. One delegation disagreed that developing countries were being marginalized, pointing out that as a group they had increased their exports in recent years, that they had maintained or increased their share of world trade and that absolute volume of foreign direct investment flows to these countries had increased. The same delegation said that only those countries that had suffered internal conflicts or had non-market economies might continue to experience marginalization. Another delegation observed that the absolute amount of foreign direct investment going to developing countries had risen and that developing countries could find new opportunities in the globalization strategies of transnational corporations from the triad, which implied a continual search for new markets and production locations, as well as opportunities in the growth of outward foreign direct investment from non-triad countries.

12. Several delegations from developed countries also described measures their Governments had taken to encourage investment in developing host countries. One delegation from a developed country noted that its Government had entered into numerous bilateral investment treaties in order to promote outward foreign direct investment. Other measures described by delegations included technical assistance and feasibility studies, the granting of preferential interest rates and financial guarantee systems. Some delegations described new programmes instituted by their Governments involving the creation of regional funds to stimulate joint ventures between firms from developed countries and those in developing countries.

13. Some delegations from Central and Eastern European countries expressed concern about the concentration of foreign direct investment in the triad. They also elaborated on the measures taken by their Governments to integrate their States into the world economy and encourage foreign direct investment, including major changes in investment laws, exchange regulations and privatization of state enterprises.

14. Noting that foreign direct investment was an engine of growth, several delegations raised the issue of governance, calling for additional action to address imbalances in the world-wide distribution of foreign direct investment flows. Such action would have to be multi-level, involving national, regional, and international participation. Also noting the fact that no single country could regulate the activities of transnational corporations by itself, some delegations called for a set of multilateral disciplines to

ensure that activities of transnational corporations conformed to the development objectives of host countries. Several delegations also called for technical assistance in the area of infrastructure and human resource development to promote a better climate for foreign direct investment.

15. Many delegations expressed the view that the Centre should continue its work in collecting and analysing data on world stocks and flows of foreign direct investment, examining the role of transnational corporations in the world economy and identifying the reasons for the declining share of developing countries in world-wide foreign direct investment flows. They stated that future research should examine the role of foreign direct investment as an engine of world-wide economic growth and the interlinkages between foreign direct investment, trade, technology transfer and financial flows. Among the suggestions for future research made by one delegation were the economic impact of foreign direct investment on host countries, particularly with regard to industrial transformation, and human resources development. Delegations commended the report of the Secretary-General (E/C.10/1991/2).

16. In his concluding remarks, the Executive Director noted that the world was witnessing a fundamental change in the role of transnational corporations through their interactions with trade, investment, technology, financial flows and the environment. He observed that there was a need for further analysis and better understanding of that complex process, including the questions of how regionalization among developed countries was going to affect the distribution of foreign direct investment flows and the observed clustering of developing countries around one of the triad members in foreign direct investment relationship in order to formulate appropriate policy responses. With regard to the issue of marginalization of developing countries, he acknowledged that there was no simple answer. While those countries experienced an absolute increase in foreign direct investment inflows, the fact that their share had declined demonstrated a relative neglect of those countries by transnational corporations.

Action taken by the Commission

17. The Commission took note of the report of the Secretary-General on recent developments related to transnational corporations and international economic relations (E/C.10/1991/2) and commended the report for its analytical quality and choice of topical issues, which were helpful in facilitating policy-oriented discussions. It requested the Secretariat to continue its work on the subject in the light of the comments and suggestions made by delegations and to submit to the Commission at its eighteenth session reports dealing with trends in foreign direct investment and the role of transnational corporations in world development.

Presentations by expert advisers

18. The Commission heard presentations by three expert advisers on the subject of recent developments related to transnational corporations and international economic relations. One expert adviser, Mr. Oswaldo Sunkel, observed that, although there existed a causal relationship between growth and foreign direct investment, that relationship was not straightforward. The relationship occurred through the creation of additional capital formation; if the latter was productive, then foreign direct investment led to growth. But foreign direct investment did not necessarily increase capital formation. Foreign direct investment was the acquisition of assets in a foreign country; that might take the form of acquisition of existing assets, which did not necessarily contribute to economic growth. In fact, it was likely that most of the foreign direct investment boom of the 1980s was mainly investment of that kind. It was necessary to know what proportion was additional capital formation in order to ascertain whether there was any growth as a result of foreign direct investment. He noted that foreign direct investment needed to be measured in relation to the size of the receiving country. An apparently small amount might be a high proportion of gross domestic product (GDP) in some countries. Also, it was necessary to disaggregate foreign direct investment; for instance, whether it was mainly in services or manufacturing, for the local market or for export, whether it brought new technology to a country or not. The capital/output ratio for each of those types of foreign direct investment would be different and would have a different impact on the growth of the host country. It had not been clearly established that foreign direct investment definitely led to increased investment or exports in all countries.

19. An important factor behind the fact that foreign direct investment was low in developing countries and was highly concentrated was protectionism in the three poles of the triad, particularly in Japan. All three main members were highly protected, especially in agriculture and primary materials, but also in manufactures. A coalition of interests between developing countries and the affiliates of transnational corporations based there could contribute to a reversal of such protectionism.

20. In Latin America, a high proportion of foreign direct investment was forced by the mechanism of debt-to-equity swaps and much of that investment was closely linked to privatization of state enterprises under adjustment policies. Such foreign direct investment might benefit private firms but without necessarily benefiting the host country.

21. Ms. Sylvia Ostry, in her presentation, observed that there had been three phases of internationalization in the world economy since the Second World War:

(a) The emergence and development of relatively unfettered international trade linkages articulated through the multilateral framework of the General Agreement on Tariffs and Trade (GATT);

(b) An unplanned wave of financial integration, induced by accidents of the OPEC oil shocks, the Japanese and German surpluses in the 1970s and the 1980s and facilitated by the policies of President Ronald Reagan in the United States and Prime Minister Margaret Thatcher in the United Kingdom;

(c) In the mid-1980s, there had been the beginning of a new movement dominated by investment and technology flows, the agent of which was the transnational corporation.

22. The implications of the third wave were only beginning to be understood. To understand them, it was necessary to look at technology flows, the diffusion of research and development and the explosion of strategic alliances based on technology cooperation, which was even more concentrated in the triad than foreign direct investment: 97 per cent of strategic alliances were in the triad.

23. What that trend implied was a change in the nature of competition, not just among firms but also among systems. The ability to compete depended on the relationship between the firm and its environment, and that was taking the form of three dominant models: those of Japan, Europe and the United States. The differences among those models gave rise to a kind of friction, which the expert referred to as "system friction". The struggle for market share was a struggle for high technology. Those high-technology sectors depended on the system they operated in, so it was now the systems that were competing, not merely the firms.

24. Another important trend in the world of transnationals was the decline of the United States. The first wave of transnational corporations was 99 per cent American. Currently, there were other players on the scene. Moreover, there was asymmetry in the triad. It existed in trade, with different import propensities of the triad members causing friction, but the most striking asymmetry was in foreign direct investment, in which the most glaring imbalance existed in the case of foreign direct investment inflows to Japan.

25. There appeared to be a regionalization of foreign direct investment. In Europe, it was brought about by the 1992 European Community programme, in Japan by the yen shock and a strategic move of Japanese transnational corporations outwards, which also included a degree of concentration in Asia and in North America, with the United States/Canada and United States/Mexico relationships creating powerful investment linkages in the region.

26. The United States was no longer a multilateralist. It now followed a three-track policy in trade and investment involving bilateralism (i.e., its relationships with Canada and with Mexico); unilateralism (i.e., its 301 policies and Strategic Impediments Initiative) and multilateralism (its GATT activities).

27. Until the present time, trade liberalization had been a force for convergence. There was convergence of growth, of policies and of

technological capacities. The major reason for that convergence was the hegemony of the United States and the multilateral system. The question was whether current trends were a force for convergence or divergence in the world economy. Now there was a triad and no hegemon, a danger to the multilateral system and a new competitiveness paradigm. They might aggravate divergence among world economies.

28. Mr. Chakufka Chihana noted that the report of the Secretary-General on recent developments was rightly focused on the emergence of the triad as a dominant factor in global investment relationships. The declining share of developing countries in world foreign direct investment inflows was likely to be further aggravated by the regionalization policies pursued by the triad members as well as the corporate strategies of transnational corporations, most of which were located in the triad. The policy changes in developing countries were no longer sufficient to attract transnational corporations. Foreign direct investment was determined by a host of factors many of which were beyond the control of developing countries. Moreover, they had to compete among themselves for foreign direct investment inflows. One policy response that developing countries should pursue was to have their own regional arrangements. Most of the existing arrangements had not functioned effectively because of the lack of adequate political support. Such regional arrangements among developing countries should not be intended as a way to confront similar arrangements among developed countries, but as a means to enhance their own economic security. Moreover, developing countries should make every effort to ensure both political and economic stability.

29. At the end of the presentations, the expert advisers answered questions raised by delegations.